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Ninety One

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Practical guide to section 10C

At a glance

Section 10C of the Income Tax Act, 58 of 1962, provides a tax exemption for qualifying annuity income. The exemption applies where retirement fund contributions were:

- not previously deductible under section 11F because they exceeded the applicable limits; and
- not already used to reduce the tax payable on a retirement or withdrawal lump sum under the Second Schedule.

Key mechanics of section 10C

- Section 10C does not provide an upfront rebate and does not reduce PAYE deducted from annuity income during the year; any tax benefit is only realised as a refund on assessment. The South African Revenue Service (SARS) currently does not issue upfront tax directives related to section 10C.
- The exemption is only available to the member who made the retirement fund contributions and cannot be transferred to beneficiaries.

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How do disallowed contributions (also referred to as excess contributions) arise?

Section 11F limits the annual tax deduction for retirement fund contributions. The deduction is capped at the lesser of:

- R430 000; or
- 27.5% of the higher of remuneration or taxable income (including capital gains); or
- taxable income (excluding capital gains).

Any retirement fund contributions above the deductible amount are not lost. They are retained and will be applied to obtain tax relief at a later stage.

Disallowed contributions are applied in the order in which the relevant tax event arises

Before retirement

Excess contributions are carried forward and may be deducted under section 11F in subsequent tax year(s), subject to the applicable limits. A section 11F deduction will continue to be applied annually, while excess contributions remain available, even after the member has retired from the retirement fund.

At retirement

Where a retirement or withdrawal lump sum is taken, any remaining excess contributions must be applied to reduce the taxable portion of that lump sum under the Second Schedule, before the withdrawal or retirement tax table is applied.

After retirement

Excess contributions may be used to exempt qualifying annuity income under section 10C, to the extent that a balance still remains.

Important: Disallowed contributions are aggregated across all retirement funds and are applied in the order in which the tax event occurs. Where a retirement or withdrawal lump sum arises, any remaining excess contributions must first be applied against that lump sum and cannot be deferred for later use under section 10C.

What constitutes a qualifying annuity in terms of section 10C?

A qualifying annuity is an annuity payable from retirement interest, including a living annuity, in the circumstances listed in section 10C(1) of the Income Tax Act. These annuities are commonly referred to as "compulsory annuities".

Note: A pension paid by the **Government Employees Pension Fund (GEPF)** does not constitute a qualifying annuity for the purposes of section 10C. Therefore, a section 10C exemption will not be applied in respect of a pension paid by the GEPF.

Important practical points

- The section 10C exemption cannot be applied in the same tax year that excess contributions arise. It is only available in the subsequent year(s).
- The exemption is only available to the member of the retirement fund who made the contributions. It cannot be transferred to any subsequent holders of the annuity, i.e. beneficiaries after the death of the annuitant.
- Administrators of compulsory annuities are required to deduct PAYE in full from the annuity income in accordance with the applicable tax tables before making payment to the taxpayer. The section 10C exemption is only applied by SARS on assessment and may result in a full or partial refund of PAYE where the taxpayer qualifies. The extent of any tax relief depends on the value of the excess contributions available.
- The taxpayer's latest ITA34 reflects the balance of disallowed contributions recognised by SARS. It is important to keep an eye on this balance, to ensure that retirement fund contributions have been correctly captured by SARS.

Example: How section 10C works in practice

Scenario 1

John retires from his pension fund and elects to take a lump sum of R2 500 000. The balance of his benefit is invested in a living annuity. John has R4 000 000 of previously disallowed contributions.

John receives living annuity income of:

- R900 000 in year 1, and
- R1 000 000 in year 2.

Application of disallowed contributions to the retirement lump sum first (Second Schedule)

Retirement fund lump sum	R2 500 000
Less disallowed contributions (limited to the lump sum)	(R2 500 000)
Taxable lump sum (to which the retirement tax table will be applied)	R0

Outcome

No retirement lump sum tax is payable on the lump sum.

Note on the R550 000 tax-free portion in terms of the retirement tax table:

- As excess contributions are deducted before the retirement tax table is applied, the R550 000 tax-free portion has not been utilised and remains available for other retirement fund benefits (assuming no prior retirement fund lump sums have been received). If no other retirement fund lump sums are received, the benefit of the R550 000 tax-free portion will effectively be lost.
- A member cannot elect to have the retirement tax table applied before the excess contributions are utilised.

Remaining balance of disallowed contributions

(R4 000 000 – R2 500 000)	R1 500 000

Application of remaining disallowed contributions as a section 10C exemption against annuity income

Year	Annuity income	10C exemption (limited to income)	Taxable annuity income	Remaining disallowed contributions
1	R900 000	(R900 000)	R0	R600 000
2	R1 000 000	(R600 000)	R400 000	R0

Outcome

In year 1, annuity income is fully exempt. In year 2, only R600 000 is exempt and the balance is taxable.

How will a taxpayer receive the section 10C benefit from SARS?

The annuity administrator will issue an IRP5/IT3(a) reflecting the taxpayer's annuity income. SARS uses this information, together with the taxpayer's historical retirement fund contribution data, to calculate the exempt portion of the annuity. Where all retirement fund contributions (including excess contributions) have been correctly claimed in prior tax years, the section 10C exemption is generally applied automatically on assessment.

Where SARS does not apply the exemption despite it being available, the taxpayer may need to request a correction or lodge an objection, supported by ITA34s and tax certificates.

Remember: Excess contribution balances are shown on the taxpayer's ITA34.

Excess contributions and estate duty implications

Retirement fund benefits and compulsory annuities are **excluded from property** for the purposes of calculating estate duty, in terms of section 3(2)(i) of the Estate Duty Act.

Important

Section 3(3)(e) of the Estate Duty Act deems the value of excess contributions to be property for estate duty purposes, to the extent that a lump sum is received.

If the spouse receives the retirement fund/annuity benefit as beneficiary, the section 4q deduction will not be available, as section 3(3)(e) states that the excess contributions are deemed to accrue to the deceased, and not to the spouse.

Let us apply these sections to our example.

Scenario 2

John passed away after year 1, at which point his remaining excess contributions amount to R600 000.

Assumptions:

John's wife is the nominated beneficiary.

The R3.5 million abatement has been utilised.

If John's wife elects to receive the full benefit as an annuity:

- The compulsory annuity is exempt from estate duty in terms of section 3(2)(i) of the Estate Duty Act.
- The excess contributions of R600 000 will not be included in the estate for estate duty purposes.
- Annuity income will be subject to tax in the hands of the spouse – depending on her income, up to 45%. The spouse does not receive the 10C exemption.

If John's wife elects to receive the full benefit as a lump sum:

- The compulsory annuity is exempt from estate duty in terms of section 3(2)(i) of the Estate Duty Act.
- Excess contributions of R600 000 will be included in the estate for estate duty purposes (section 3(3)(e) of the Estate Duty Act) and be subject to estate duty of R600 000 x 20% = R120 000. In our view, the section 4q deduction will not be available as the excess contributions are deemed to accrue to the deceased, not to the spouse.
- The lump sum benefit is subject to tax in accordance with the retirement tax table in the hands of the deceased (up to a maximum rate of 36%), after deducting the disallowed contributions of R600 000. John's wife therefore receives R600 000 of the benefit tax-free.

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Contact information

36 Hans Strijdom Avenue
Foreshore, Cape Town 8001
Telephone: +27 (0)21 901 1000
Client service support: 0860 500 100
Email: clientservice@ninetyone.com
Financial advisors: Advisor Service Centre: 0860 444 487
Alternatively, please contact your Ninety One investment consultant.
www.ninetyone.com

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